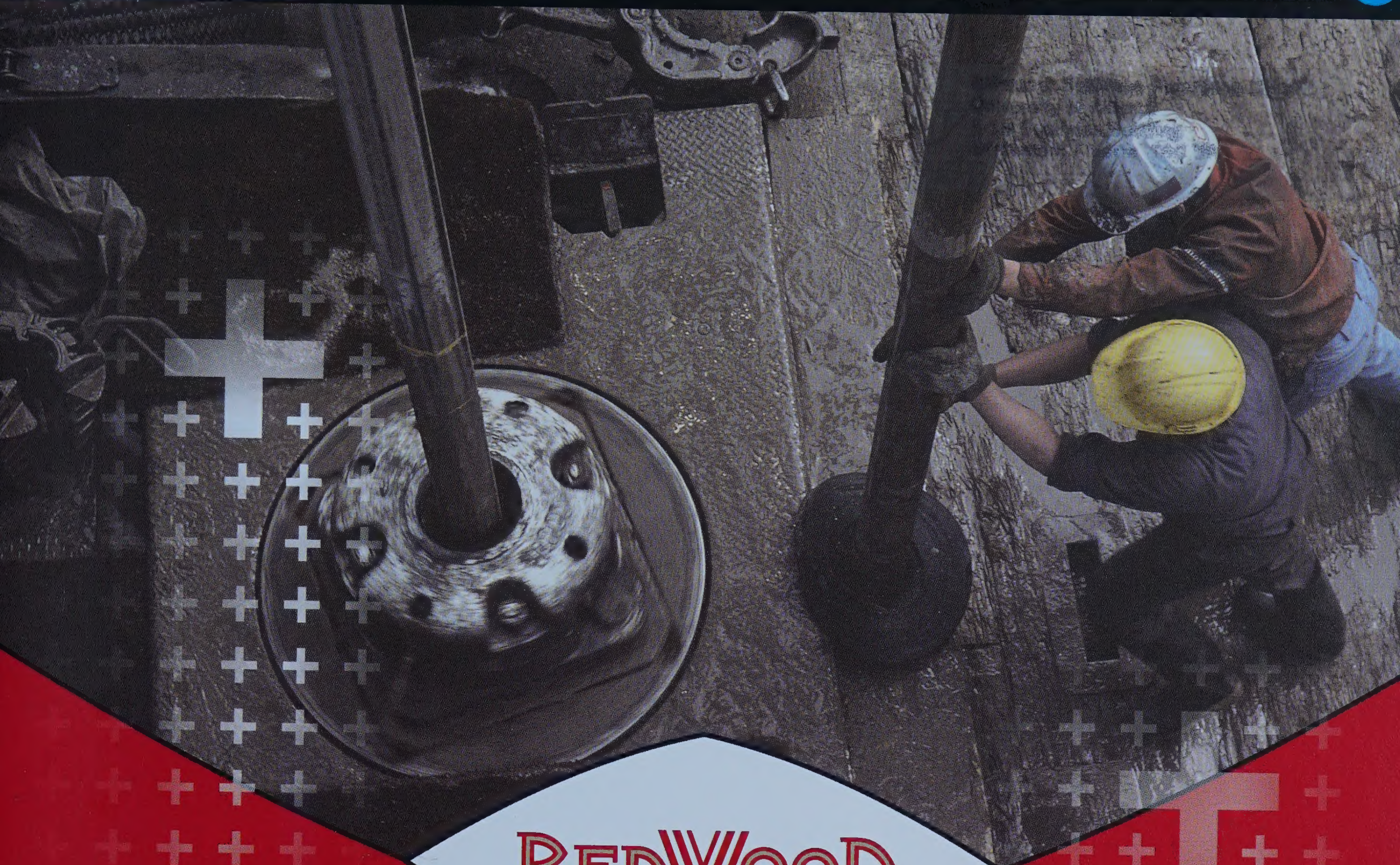
Annual Report 2001



REDWOOD

Forging ahead in the new millennium

+	*acquired Garran Oil and Gas, consisting primarily of producing gas wells*
+	*successfully completed development drilling at Rosevear*
+	*successful exploration at Carnwood*
+	*purchased Tinhorn Resources, balancing Redwood's gas with Tinhorn's oil*
+	*acquired property adjacent to Rosevear, opening up development opportunities*
+	*successful development drilling in the first quarter of 2002*
=	*Redwood met the challenges of a volatile year to emerge stronger, with its balance of oil and gas production, and on track with its strategy for growth*

Redwood Energy, Ltd. is a *junior oil and gas company* **based in Calgary with**

	Three Months Ended		Twelve Months Ended	
	Dec. 31, 2001	Dec. 31, 2000	**Dec. 31, 2001**	Dec. 31, 2000
Operations				
Natural Gas Sales (mcf)				
Total	252,199	0	**1,182,119**	5,478
Daily Average	2,740	0	**3,239**	15
Average Natural Gas Price ($)	3.76	N/A	**6.28**	3.15
Oil and NGL Sales (bbls)				
Total	6,688	473	**31,300**	2,190
Daily Average	73	5	**86**	6
Average Oil & NGL Price ($)	23.35	41.73	**34.02**	43.44
Total Daily Sales boe (6:1)	530	5	**626**	9
Financial				
Revenue ($)	994,369	33,240	**8,508,400**	207,156
Cash Flow from Operations ($)	824,249	(64,340)	**4,308,423**	(204,277)
Per Share (Weighted Average)	0.04	(0.01)	**0.21**	(0.03)
Fully Diluted	0.04	(0.01)	**0.21**	(0.03)
Net Earnings ($)	(1,409,782)	(4,897)	**(562,776)**	426,780
Per Share (Weighted Average)	(0.07)	(0.00)	**(0.03)**	0.06
Fully Diluted	(0.07)	(0.00)	**(0.03)**	0.06
Capital Expenditures ($)	1,733,816	(10,481)	**28,528,192**	1,415,725
Common Shares Outstanding	22,819,202	7,690,147	**22,819,202**	7,690,147
Weighted Average	20,659,164	7,690,147	**20,247,588**	6,744,743

its primary area of exploration and production activity in *Western Canada.*

The year 2001 was indeed an odyssey for the oil and gas industry in general, and for Redwood in particular. The industry began the year riding the crest of a wave of commodity prices that drove revenues up, resulting in record high cash flows and earnings for many companies. This in turn drove activity levels up, increasing the cost of field operations and land or property acquisitions.

A good start, with the Garran acquisition

The year signaled a new beginning for Redwood, starting with the closing of the Garran Oil and Gas acquisition and the associated public offering of common shares and debentures. The acquisition, which we negotiated in the summer of 2000, consisted primarily of producing gas wells in the Rosevear area of Alberta, just east of Edson. Gas sales in the first quarter averaged just over 4 mmcf/d, slightly higher than had been anticipated. With the high gas prices, the sales generated $3.5 million of revenue and $1.8 million of cash flow for the quarter. These levels of production and revenue were many times what they had been in prior years for Redwood. In addition, the bulk of production was now company operated.

As the year progressed, however, commodity prices sank and the bullish expectations waned. Merger and acquisition activity slowed somewhat as well, as the gap between buyer and seller expectations widened. By the end of the year, in general, forecasted prices of oil and gas had been substantially reduced, particularly for the short term, reflecting what the industry was experiencing in the last quarter of 2001. For the year, Redwood recorded cash flow of $4.3 million from average production of 626 boe/d.

A challenging season, with success late in the year

While development drilling at Rosevear was successful, our two early exploration attempts, re-entries at Pine Creek and Basing, were not. Later in the year, we had exploration success on a re-entry farm-in at Carnwood, which yielded commercial Viking gas. A second farm-in in the Rosevear area, which was delayed until January of the new year, was also successful in establishing gas reserves and a new gas trend for future drilling followup.

Throughout the year, the company continued to actively pursue further corporate and property acquisitions. But many of the opportunities evaluated either failed to provide the strategic benefits that we were looking for or the sellers' expectations were unrealistically high until later in the year when commodity price expectations were lower.

Renewed expansion, with the Tinhorn acquisition

Just prior to year-end, we reached agreement with the board of directors and major shareholders of Tinhorn Resources Ltd. to make a takeover bid to all the Tinhorn shareholders. The takeover bid circular was subsequently mailed on February 7, 2002. Approximately 97% of the shares were tendered to the bid and taken up pursuant to the bid on March 15, 2002. The remaining 3% of Tinhorn shares have subsequently been acquired.

Corporate Strategy: the company *strategy for growth* **is three-pronged:**

maintain a balance of oil and gas prospects;

The major property of Tinhorn is located in the Rainbow Lake area of Alberta and is primarily oil production, providing a balance to Redwood's current focus on gas production. The property includes six producing wells, one re-drill opportunity, two horizontal re-entry opportunities and an exploration prospect with up to eight potential locations. The re-drill began in February under a farm-in arrangement prior to the takeover and yielded a Wabamun gas well. The other re-entry and exploration operations will not be initiated until next year's winter season. We expect that the Tinhorn properties, including the new Wabamun well, will contribute approximately 400 boe/d of production in the remainder of 2002.

Continued expansion, with property acquisitions

In December, we began discussions regarding the acquisition of a property adjacent to our Rosevear core area. A letter of intent was entered into on February 9, 2002, to acquire, in conjunction with an industry partner, the interests of two private companies in 6½ sections of land on trend to the northwest of our existing Rosevear holdings. We also have farm-in and purchase rights on an additional five sections. The farm-in well was drilled in the first quarter of this year and has been completed as a Viking gas well.

A successful growth strategy, through acquisitions and exploration

Our two recent acquisitions provide numerous exploration and development opportunities to pursue in the coming year. Add to that the new prospect areas developed internally over the last 12 months, and Redwood will have a high level of operational activity in 2002 and beyond. We will fund the capital program through cash flow, existing and acquired, as well as through the use of the proceeds of a flow-through share issue that was accomplished in December 2001 and additional flow-through and common equity issues recently announced.

A successful exploration and development program will maintain the rapid growth rate in Redwood's production profile as we continue with our growth strategy.

Thank you, to staff and board members

I would like to thank Mr. Christen Dempster and Mr. Ernest Sorochan, former members of the board who have resigned in the past year, for their contribution to the company. Also, I would like to thank the small, but dedicated staff of Redwood for their efforts, and the members of the board of directors for their support and guidance throughout this volatile past year. We all look forward to another successful year at Redwood.

Robert P. Petryk
President and Chief Operating Officer
April 2, 2002

seek acquisition opportunities with solid potential; build assets step by step through *exploration and acquisition* **to increase profitability and stability.**

Operations Review

Redwood began the 2001 year with the closing of the Garran acquisition, which consisted of mostly operated properties in the Rosevear area. Production went from a December 2000 rate of 5 boe/d to a January 2001 rate of over 800 boe/d. During the year, we undertook five drilling and re-entry operations, resulting in three gas wells and two dry holes.

We continued to pursue acquisition opportunities throughout the year, culminating in two acquisitions in the first quarter of 2002:

- *Tinhorn Resources Ltd., a publicly traded CDNX company*
- *Producing properties with development potential in the Rosevear area from two private companies*

Exploration and development potential on the newly acquired lands, along with prospects generated both internally and externally, will provide a strong slate of drilling opportunities for the coming year. And, adhering to our strategy, we will continue to pursue acquisitions with development potential.

Rosevear

The Rosevear property, located approximately 150 km west of Edmonton, produces natural gas and natural gas liquids (NGLs). Through the acquisition of Garran, Redwood acquired 21½ sections of land that had 14 producing wells. An additional well was tied in for production and a development well was drilled in the first quarter of the year, which was subsequently tied in for production in September. A second well was drilled in the third quarter, which was cased and completed as a gas well.

Production rates

Production rates at Rosevear began the year strongly with the wells, relatively new, exhibiting flush production from the high permeability stringers in the Viking formation. Rates declined as these stringers depleted to lower but more stable production from the lower permeability main sand body. At the lower production rates, liquid loading also hampered gas production, which was alleviated through the installation of plunger lift systems.

Further drilling

We negotiated a farm-in on a 7½ section block west of our existing Rosevear acreage; however, we did not begin drilling until January of 2002. The well, which earned the company a 34% working interest in two sections, was completed as a gas well. It will be tied in before spring breakup, weather permitting. We are currently reviewing a followup location on the farm-in block.

Additional acreage

Late in the year, we began negotiations with two private companies for interests in production and undeveloped lands consisting of 11½ sections adjacent and to the northwest of our Rosevear acreage. On February 27, the acquisition was closed on 6½ sections while a farm-in was entered into to earn 2½ additional sections. As well, it included an option to purchase the remaining interests of the two private companies in the farm-in block and 1½ additional sections after drilling the farm-in well.

This arrangement provides up to seven development and stepout drilling locations for Redwood to pursue. Our average working interest on the acquired lands is 23%. The acquisition included four producing wells, with net daily production to Redwood of approximately 370 mcf of gas and 19 bbls of oil and NGLs, or 80 boe/d. Redwood will have purchased or earned interests in 33½ sections of land in the Rosevear area, of which 22½ sections are operated by the company.

Before
Acquisitions

After Acquisitions

Tinhorn acquisition

In December 2001, an agreement was reached with the board of directors and major shareholders of Tinhorn Resources Ltd. to offer to purchase all of the outstanding shares of Tinhorn in exchange for 0.9 Redwood shares for each Tinhorn share. The offer was distributed to the Tinhorn shareholders on February 7, 2002, and the shares tendered to the offer, representing 97% of the outstanding shares, were taken up as of March 15, 2002. The remainder of the shares were taken up pursuant to the mandatory acquisition provisions of the Alberta Business Corporations Act.

Production balance

The Tinhorn acquisition brings production of approximately 150 bbls/d of oil and NGLs and 1.5 mmcf/d of gas. Two-thirds of the gas production comes from a well drilled by Redwood, pursuant to a farm-in prior to the takeover, in the first quarter of 2002. The oil production, recently increased by a workover on one of the wells, lends balance to Redwood's primarily gas production.

Core property

Tinhorn's core property is at Rainbow Lake in northern Alberta. The Rainbow property includes nine wells: five pumping oil wells, two gas wells and two suspended oil wells. It includes an exploration prospect covering six sections of land with at least eight potential locations identified by 3-D seismic. There are also two Keg River reef producers with horizontal re-entry potential.

Minor, non-operated properties acquired with Tinhorn include two wells (.34 net) at Shekilie, a royalty interest in one well at Hairy Hill and an average 2% working interest in four wells at Lapp, B.C. Two additional wells have been proposed by the operator of the Lapp property, one for potential oil production and one for water disposal.

Drilling

In addition to acquisitions, Redwood pursues growth through exploration and development of new and existing prospects. In 2001, we drilled in two new areas, Basing and Carnwood, as well as at Pine Creek, an extension of the Rosevear core area. In total, we participated in the drilling and re-entry of five (2.37 net) wells in 2001, of which three (1.85 net) were exploratory and two (0.52 net) were development. Redwood operated two of the five wells.

The drilling program resulted in three (1.27 net) gas wells and two (1.1 net) dry holes for an overall success rate of 60%.

We expect to participate in the drilling of at least 10 locations in 2002. Three of these have already been drilled since year-end, and all of them have been cased for gas production. Two of the wells will be tied into the existing Rosevear gathering system.

Drilling Activity

	Year Ended							
	Dec. 31, 2001		Dec. 31, 2000[1]		June 30, 2000		June 30, 1999	
Wells	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Oil	0	0	0	0	2	0.80	1	0.12
Gas	3	1.27	1	0.35	2	0.15	3	0.18
Dry	2	1.10	0	0	2	0.15	2	0.14
	5	**2.37**	**1**	**0.35**	**6**	**1.10**	**6**	**0.44**

[1] *Year ended December 31, 2000, was a transition year consisting of the 6 months ended December 31, 2000.*

Production

Our production in 2001 was primarily from the Rosevear area, with average daily gas and liquids sales of 3.2 mmcf and 86 bbls, respectively. We exited the year with sales of 2.4 mmcf/d and 60 bbls/d of liquids, reflecting the relatively high initial decline characteristic of new Viking wells in the area.

The high liquid content of the wells created wellbore loading problems as flowing pressures declined. This was remedied with the installation of plunger lift systems where appropriate.

The year began with 14 wells tied in for production, 12 of which were operated by Redwood. Two additional wells were tied in during the year, again both operated by Redwood.

The two acquisitions, mentioned previously, as well as three successful wells drilled in the first quarter will add substantially to Redwood's production in the coming year.

Reserves

An independent corporate reserve determination and economic evaluation of the oil and gas assets of Redwood was prepared by Ashton Jenkins Mann, Petroleum Consultants, effective January 1, 2002. Proven plus probable reserves totaled 10.2 bcf of natural gas and 265,000 bbls of NGLs after production for the year of 1.2 bcf and 30,000 bbls. This compares to almost no reserves at the end of 2000, as we had disposed of our interests in two non-operated producing properties during 2000, and the only property remaining was Lodgepole/Elkhorn for which proved reserves are negligible.

The present value of Redwood's established reserves (proved plus one half of probable), at year end, discounted at 10% before tax, was $18.5 million according to the reserve report. Proved reserves represent 85% of the total.

Land

As of December 31, 2001, Redwood held interests in 40,160 gross (10,585 net) acres in Canada and the U.S. Over two-fifths of the acreage is developed, reflecting the development efforts that have taken place on the Rosevear property.

Land Holdings

	Developed Acreage		Undeveloped Acreage		Total Acreage	
	Gross	Net	Gross	Net	Gross	Net
Canada						
Alberta						
As at Dec. 31, 2000	1,280	416	15,840	4,849	17,120	5,265
As at Dec. 31, 2001	14,720	4,446	18,080	5,617	32,800	10,063
% Change	+1050%	+969%	+14%	+16%	+92%	+91%
U.S.						
Utah and Wyoming						
As at Dec. 31, 2000	1,600	159	5,760	363	7,360	522
As at Dec. 31, 2001	1,600	159	5,760	363	7,360	522
% Change	0%	0%	0%	0%	0%	0%
Total						
As at Dec. 31, 2000	2,880	575	21,600	5,212	24,480	5,787
As at Dec. 31, 2001	16,320	4,605	23,840	5,980	40,160	10,585
% Change	+467%	+700%	+10%	+15%	+64%	+83%

Present Value of Reserves

Escalating Price Forecast as of January 1, 2002

	Reserves			Present Value before Income Tax (*$ thousands*)			
	Oil (mbbls)	Gas (mmcf)	NGLs (mbbls)	Undisc.	10%	12%	15%
Proved developed	–	5,101	127	22,808	12,635	11,616	10,384
Proved undeveloped	–	1,493	37	6,144	3,085	2,772	2,404
Total proved	–	6,594	164	28,952	15,720	14,388	12,788
Probable additional	–	3,619	101	21,894	5,503	4,615	3,668
Total proved plus probable	–	10,213	265	50,846	21,223	19,003	16,456
Less 50% probable	–	1,809	50	10,947	2,751	2,307	1,839
Total established reserves	**–**	**8,404**	**215**	**39,899**	**18,472**	**16,696**	**14,617**

Changes in reserves through the year resulted from the acquisition of Garran, production, additions due to drilling and through reserve revisions. The acquisition was based on a reserve report dated July 1, 2000, which was updated effective January 1, 2001, from which the values in the following reserve continuity summary are derived. The majority of reserve additions during the year were as a result of the Garran acquisition, while minor additions resulted from drilling at Carnwood. No reserves have been assigned to Haro or Lodgepole/Elkhorn in this discussion.

Reserve Continuity Summary

	Natural Gas (mmcf)		NGLs (mbbl)		boe (6:1) (mbbl)	
	Proved	Probable	Proved	Probable	Proved	Probable
January 1, 2001	0	0	0	0	0	0
Acquisitions	10,484	3,534	143	59	1890	648
Discoveries/extensions	288	19	10	0	58	3
Production	(1,182)	0	(30)	0	(227)	0
Revisions	(2,996)	66	41	42	(458)	56
January 1, 2002	6,594	3,619	164	101	1,263	704

Subsequent to year-end, reserves in the order of 3.2 bcf and 1.1 mmbbl, as estimated by management, have been added through the acquisitions of both Tinhorn and a property in the Rosevear area.

Management's Discussion & Analysis

This review is management's discussion and analysis of the results of operations for Redwood and should be read in conjunction with the audited financial statements of the year ended December 31, 2001.

Production

Natural gas production increased from 15 mcf/d in 2000 to 3,239 mcf/d in 2001, an increase of 3,224 mcf/d. Crude oil and natural gas liquids (NGLs) daily production increased by 80 bbls/d, from 6 bbls/d to 86 bbls/d. The increase in production was a result of the acquisition of Garran in January 2001. During 2001, Redwood's natural gas production was 1,182,119 mcf, and crude oil and NGLs production was 31,300 bbls.

Average Daily Production

(12 months ended)	**2001**	2000		% Change
Oil & NGLs (bbls/d)	**86**	6	80	1,333%
Natural gas (mcf/d)	**3239**	15	3224	21,493%
Oil equivalent (boe/d) (6:1)	**626**	9	617	6,856%

Oil and gas revenue

Redwood's oil and gas revenue rose from $162,620 in 2000 to $8,498,887 in 2001, an increase of $8,336,267. Again, the increase is directly attributable to the acquisition of Garran.

Oil and Gas Revenue

(12 months ended)	**2001**	2000	$	% Change
Oil & NGLs revenue	**$ 1,065,091**	$ 124,630	$ 940,461	755%
Natural gas revenue	**$ 7,433,796**	$ 37,990	$ 7,395,806	19,468%
Oil & gas revenue	**$ 8,498,887**	$ 162,620	$ 8,336,267	5126%

Royalties

Royalties, which include crown and overriding royalties net of Alberta royalty tax credit, increased from $37,357 to $2,027,574, a result of higher gross revenues from increased production. As a percentage of production income, royalties increased from 23% in 2000 to 24% in 2001.

Operating expenses

Higher production volumes caused operating expenses to increase from $48,604 to $922,404 in 2001. On a barrel-of-oil-equivalent basis, the operating costs were $4.04 in 2001 compared to $15.66 in 2000, a 74% decrease that is directly related to the lower operating cost properties acquired from Garran.

Operating Netbacks

	2001	2000	% Change
Selling price per boe	**$ 37.22**	$ 52.41	-29%
Royalty expense per boe	**$ 8.88**	$ 12.04	-26%
Operating expense per boe	**$ 4.04**	$ 15.66	-74%
Operating netback per boe	**$ 24.30**	$ 24.71	-2%

General and administrative expenses

General and administrative expenses increased from $238,354 in 2000 to $692,861 in 2001, an increase of $454,507 or 191%. During 2001, Redwood used professional consultants for various administrative, technical and accounting functions associated with administrating and operating the producing properties from the Garran acquisition. In addition, the company was more active both operationally and in acquisition targeting in 2001.

Interest expenses

Interest expenses increased from $27,874 last year to $572,052 in 2001. Of this amount, $288,962 is interest on the debenture issued January 12, 2001, in conjunction with the financing of the acquisition of Garran. Interest paid on the company's revolving credit facility is $264,999 and miscellaneous interest is $18,091.

Bank loan

Redwood has a $6,000,000 revolving production loan facility, of which $4,750,000 was drawn at December 31, 2001. The revolving loan bears interest at bank prime plus 1.25%. We utilized the revolving line of credit to finance the Garran acquisition, as well as to maintain ongoing operations.

Depletion, depreciation and site restoration

Depletion, depreciation and site restoration expenses increased from ($2,569) in 2000 to $4,954,544 in 2001 as a result of increased production, a larger asset base and a higher depletion rate. We estimated that the total liabilities for future removal and site restoration at year-end were $25,600, an increase of $21,100 over the provision for 2000.

Cash flow and earnings

Cash flow from operations increased significantly to $4,308,423 ($0.21 per share) compared to a loss of $204,277 ($0.03 per share) the previous year. This increase is due to higher revenues associated with the Garran acquisition.

The after-tax loss of $562,776 ($0.03 per share) in 2001 is primarily due to the increased depletion provision for the current period. After-tax earnings in 2000 were $426,780 ($0.06 per share), which included a gain on the sale of oil and gas interests of $610,805. Excluding this gain on sale, the loss in 2000 was $184,025 ($0.03 per share).

Income taxes

Current taxes include a Large Corporation tax of $4,201 (Canada) and an income tax recovery of $19,113 (U.S.) compared to an income tax expense of $59,131 (U.S.) in 2000.

Future income taxes payable of $9,404,754, compared to ($71,267) in the previous year, reflect the tax liability on the difference between the book value of oil and gas assets and the value of the company's resource tax pools available. The magnitude of the liability is a result of the corporate acquisition of Garran, which had limited tax pools. We will continue to defer the future tax payable subject to the ongoing level of exploration and development expenditures.

Capital expenditures

Capital expenditures totalled $28,528,192 in 2001 compared to $1,415,725 in 2000. Capital expenditures, excluding the provision for future income tax payable attributable to the acquisition of Garran Oil and Gas Ltd. amounted to $18,877,192, and excluding the acquisition of Garran entirely, amounted to $2,759,886.

Capital Expenditures

(12 months ended)	**2001**	2000
Property acquisitions	**$25,769,306**	$ 26,667
Drilling and completions	**$ 2,236,498**	$ 1,264,124
Equipment and facilities	**$ 495,413**	$ 114,959
Geological and geophysical	**$ 2,650**	$ 1,396
Other	**$ 24,325**	$ 8,579
Total capital expenditures	**$28,528,192**	$ 1,415,725

The accompanying financial statements of Redwood Energy, Ltd. have been prepared by management in accordance with generally accepted and consistently applied accounting principles. The company's accounting procedures and related systems of internal controls are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. In recognizing that the company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared accordingly and within reasonable limits of materiality. Further, management is satisfied that the financial information throughout the balance of this annual report is consistent with the information presented in the financial statements.

Buchanan Barry LLP have been appointed by the shareholders of Redwood and serve as the company's independent auditors. They have examined the financial statements of the company for the year ended December 31, 2001. The Audit Committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors. The Board has approved the financial statements of Redwood which are contained in this annual report.

Robert P. Petryk
President and Chief Operating Officer
April 2, 2002

Peter S. Ffoulkes-Jones
Chairman and Chief Executive Officer

To the Shareholders of Redwood Energy, Ltd.

We have audited the consolidated balance sheets of Redwood Energy, Ltd. as at December 31, 2001 and 2000 and the consolidated statements of loss and deficit and cash flow for the years ended December 31, 2001 and 2000. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2001 and 2000 and the results of its operations and the change in its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
March 7, 2002

Chartered Accountants

Consolidated Balance Sheets

As at December 31	2001	2000
Assets		
Current		
Cash	$ –	$ 69,441
Marketable securities	–	111,124
Accounts receivable	2,013,005	67,112
Deferred charges *(Note 3)*	17,604	57,530
Prepaid expenses	170,762	3,298
	2,201,371	308,505
Resource Properties *(Note 4)*	26,563,344	2,981,397
Capital Assets *(Note 5)*	58,909	–
Future Taxes *(Note 12)*	–	71,267
	$ 28,823,624	$ 3,361,169
Liabilities		
Current		
Bank indebtedness	$ 66,572	$ –
Accounts payable	1,736,064	229,857
Income taxes payable	12,401	59,184
Loans payable *(Note 9)*	64,537	11,985
Convertible debentures *(Note 7)*	3,000,600	–
Operating loan *(Note 6)*	4,750,000	–
	9,630,174	301,026
Future Site Restoration and Abandonment	25,600	4,500
Future Income Taxes Payable *(Note 12)*	9,404,754	–
	19,060,528	305,526
Shareholders' Equity		
Share Capital *(Note 8)*	10,639,791	3,346,288
Deficit	(876,695)	(290,645)
	9,763,096	3,055,643
	$ 28,823,624	$ 3,361,169

Approved by the Board

Director

PS Foulkes-Jones

Director

Consolidated Statements of Loss and Deficit

Years Ended December 31	2001	2000
Revenues		
Oil and gas	$ 8,498,887	$ 162,620
Interest and other income	9,513	44,536
	8,508,400	207,156
Production Costs		
Royalties and mineral taxes	2,027,574	37,357
Operating	922,404	48,604
Depletion	4,954,544	(2,569)
Amortization	25,813	–
	7,930,335	83,392
Net Production Income	578,065	123,764
Expenses		
General and administrative	692,861	238,354
Interest	572,052	27,874
	1,264,913	266,228
Loss from Operations	(686,848)	(142,464)
Other Income		
Gain on sale of oil and gas interests	–	610,805
Write-off of oil and gas interests	–	(53,584)
Loss on sale of marketable securities	–	(113)
	–	557,108
Earnings (Loss) before Income Taxes	(686,848)	414,644
Income Taxes (Recovery)		
Current	(14,914)	59,131
Future	(109,158)	(71,267)
	(124,072)	(12,136)
Net Earnings (Loss)	(562,776)	426,780
Deficit, beginning of year	(290,645)	(717,425)
Premium of Shares Returned to Treasury	(23,274)	–
Deficit, end of year	$ (876,695)	$ (290,645)
Net Earnings (Loss) per Share – Basic	$ (0.028)	$ 0.063
Net Earnings (Loss) per Share – Fully Diluted	$ (0.028)	$ 0.063

Consolidated Statements of Cash Flow

Years Ended December 31	2001	2000
Operating Activities		
Net earnings (loss)	$ **(562,776)**	$ 426,780
Depletion	**4,954,544**	(2,569)
Amortization	**25,813**	–
Gain on sale of oil and gas interests	**–**	(610,805)
Write-off of oil and gas interests	**–**	53,584
Future income taxes	**(109,158)**	(71,267)
	4,308,423	(204,277)
Change in non-cash working capital items		
Accounts receivable	**(1,945,893)**	62,681
Deferred charges	**39,926**	(57,530)
Prepaid expenses	**(167,464)**	–
Accounts payable and accrued liabilities	**1,506,207**	119,961
Income taxes payable	**(46,783)**	59,184
Future site restoration and abandonment	**–**	4,500
	(614,007)	188,796
	3,694,416	(15,481)
Financing Activities		
Increase in loans payable	**52,552**	–
Repayment of loans payable	**–**	(200,801)
Convertible debentures issued	**2,000,600**	–
Proceeds on operating loan	**4,750,000**	–
Issue of share capital	**3,994,905**	4,000
Share issue costs	**(661,478)**	–
Repurchase of common shares	**(97,634)**	–
	10,038,945	(196,801)
Investing Activities		
Acquisition of oil and gas interests	**(13,895,776)**	(1,415,725)
Acquisition of capital assets	**(84,722)**	–
Proceeds from sale of oil and gas interests	**–**	1,275,808
	(13,980,498)	(139,917)
Net Change in Cash and Cash Equivalents	**(247,137)**	(352,199)
Cash and Cash Equivalents, beginning of year	**180,565**	532,764
Cash and Cash Equivalents, end of year	$ **(66,572)**	$ 180,565
Cash and Cash Equivalents		
Cash (bank indebtedness)	$ **(66,572)**	$ 69,441
Marketable securities	**–**	111,124
	$ **(66,572)**	$ 180,565

Years Ended December 31, 2001 and 2000

Nature of Operations

The company is in the business of acquiring, exploring and evaluating oil and gas properties, and either joint venturing or developing these properties further or disposing of them when the evaluation is completed. At December 31, 2001, the company had interests in properties in Canada and the United States.

Significant Accounting Policies

The financial statements of the company have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. The financial statements have, in management's opinion, been properly prepared using careful judgement with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

(a) Consolidation

These consolidated financial statements include the accounts of Redwood Energy, Ltd. and its wholly owned subsidiary, Redwood Energy (USA), Ltd. (a Colorado, U.S.A. corporation). All significant intercompany transactions and balances have been eliminated from the consolidated financial statements.

(b) Foreign Currency Translation

The company follows the temporal method of accounting for the translation of foreign currency amounts into Canadian dollars. Under this method, all monetary assets and liabilities expressed in foreign currencies are translated at the rate of exchange in effect on the balance sheet date. All other assets and liabilities are translated at the rates prevailing on the dates the assets were acquired or the liabilities incurred. Revenues and expenses are translated at the average rate prevailing during the period. Translation gains and losses are included in income or loss for the period.

(c) Capital Assets

Oil and gas properties

The company follows the full-cost method of accounting for oil and gas activities whereby all costs associated with the acquisition of, the exploration for, and the development of oil and gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, and lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, equipment costs, and general and administrative costs directly related to the exploration and development activities. Other general, administrative and interest costs are expensed. The carrying value is limited by a ceiling test calculation to a recoverable amount as determined by estimating the current value of future net revenue from proven properties based on current prices, costs and the value of unproven properties at the lower of cost or net realizable value.

Amortization of these costs is calculated on the unit of production method based on estimated proven reserves as determined by independent engineers. For purposes of depreciation and depletion calculations, oil and gas reserves are converted to a common unit of measure on the basis of their energy content. The costs of significant unproven properties are excluded from the depreciation and depletion base.

The relative volumes of oil and gas reserves and production are converted at a ratio of six thousand cubic feet of natural gas to one barrel of crude oil.

Proceeds from the disposals of properties are normally applied as a reduction of the costs of the remaining assets unless the disposal represents a significant portion of the company's total reserves, in which case a gain or loss on disposal is recorded.

2. *Significant Accounting Policies (continued)*

Substantially all of the exploration, development and production activities of the company are carried out jointly with others, and accordingly, the financial statements reflect only the company's proportionate interest in such activities.

Office equipment

Amortization is provided annually at rates calculated to write-off the assets over their estimate of lives as follows:

- *Computer hardware – 30% declining balance*
- *Computer software – 100% declining balance*
- *Furniture and equipment – 20% declining balance*
- *Leasehold improvements – 20% straight line*

(d) Earnings (Loss) Per Share

During the year the company adopted, retroactively, the treasury stock method of calculating earnings per share as recommended by the Canadian Institute of Chartered Accountants. Under this method, only "in the money" dilutive instruments impact the diluted calculations. Diluted earnings per share have been restated to comply with the new policy.

Earnings (loss) per share is calculated using a weighted average number of common shares outstanding of 20,247,588 (2000 – 6,744,743) shares. The effect of the stock options on the earnings (loss) per share is dilutive and is reflected in the fully diluted per share calculation. The effect of the convertible debentures is anti-dilutive.

(e) Fair Value of Financial Instruments

The company's financial instruments consist of cash, marketable securities, accounts receivable, accounts payable, and a loan payable. Unless otherwise noted, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying values, unless otherwise noted.

(f) Future Site Restoration and Abandonment

The company provides for its future site restoration and abandonment costs for its petroleum and natural gas wells. The costs are management's best estimate of the future costs based on current legislation and industry practice. Total estimated costs are provided on a unit of production basis. The provision is included in depletion expense and actual costs are charged to the liability account as incurred.

(g) Future Taxes

The company follows the liability method to account for income taxes.

Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes that are likely to be realized.

(h) Flow-through Shares

The company has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of the flow-through share agreements, the tax attributed of the related expenditures are renounced to subscribers. To recognize the foregone tax benefit to the company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The tax effect of the renouncement is recorded when the corresponding exploration and development expenditures are incurred.

Deferred Charges

Deferred charges at December 31, 2001 relate to the proposed acquisition of Tinhorn Resources Ltd. referred to in Note 13. These costs will be allocated to the acquisition and equity issues upon completion of the acquisition.

December 31, 2000 deferred charges relate to the acquisition of the private oil and gas company referred to in Note 14 and the related issue of common shares, debentures and warrants.

Resource Properties

	2001 Cost	2001 Accumulated Depletion	2001 Net Book Value
Petroleum and natural gas properties	**$29,828,963**	**$ 4,906,444**	**$24,922,519**
Production equipment	**1,953,504**	**312,679**	**1,640,825**
	$31,782,467	**$ 5,219,123**	**$26,563,344**

	2000 Cost	2000 Accumulated Depletion	2000 Net Book Value
Petroleum and natural gas properties	$ 3,025,880	$ 159,442	$ 2,866,438
Production equipment	114,959	–	114,959
	$ 3,140,839	$ 159,442	$ 2,981,397

The ceiling test using commodity prices and costs at December 31, 2001 indicated a write-down of $5,000,000. The indicated write-down relates to assets which were acquired during the year. It is management's opinion that development of these properties will result in the finding of sufficient proven reserves to eliminate the need for a write-down.

Capital Assets

	2001 Cost	2001 Accumulated Amortization	2001 Net Book Value
Computer hardware	**$ 25,356**	**$ 7,607**	**$ 17,749**
Computer software	**31,727**	**15,864**	**15,863**
Furniture and equipment	**9,569**	**1,051**	**8,518**
Leasehold improvements	**18,070**	**1,291**	**16,779**
	$ 84,722	**$ 25,813**	**$ 58,909**

Operating Loan

The company has secured a revolving production loan facility available to a maximum of $6,000,000 bearing interest at prime plus 1.25%. The loan is secured by a general security agreement and postponements of claim on the $3,000,600 debentures.

Debentures

During the year the company issued $3,000,600 in subordinated convertible debentures, due December 31, 2002. These debentures are convertible, at the option of the holder at any time up to the close of business on December 31, 2002, into fully paid and non-assessable common voting shares at a conversion price of $0.60 per common share. Interest is paid half-yearly in equal installments at a rate of 10% per annum.

8 Share Capital

Authorized

Unlimited number of Class A voting common shares
Unlimited number of Class B voting common shares
Unlimited number of Class C non-voting common shares
Unlimited number of preferred shares

Issued

All shares issued are Class A voting common shares	Shares	Amount
Common shares		
Balance, December 31, 1999	7,680,147	$ 3,342,288
Issued for cash		
Stock options	10,000	4,000
Balance, December 31, 2000	7,690,147	3,346,288
Issued for cash		
Stock options	163,000	70,200
Private placement	5,431,000	2,715,500
Private placement – flow through shares	2,198,555	1,209,205
Issue costs	–	(661,478)
Tax benefit on share issue costs	–	284,436
	7,792,555	3,617,863
Garran Oil & Gas Ltd. acquisition *(Note 14)*	7,500,000	3,750,000
Repurchased for cash under normal course issuer bid	(163,500)	(74,360)
	15,129,055	7,293,503
Balance, December 31, 2001	**22,819,202**	**$10,639,791**

(a) Escrow Shares

750,000 shares are held in escrow. These shares may not be released or transferred without the consent of the Canadian Venture Exchange. Any release is based on 15% of the original number of escrow shares for every $100,000 expended on exploration and development and provided that no more than 50% of the original number of escrow shares may be released in any 12 month period. The escrow release factor will be 7.5% of the original escrow shares if administrative expenditures exceed 33% of total expenditures for any 12 month period. Any escrow shares not released from escrow by March 1, 2006 will be automatically cancelled.

(b) Options Outstanding

The company has established a stock option plan whereby options may be granted to employees, directors and key consultants. The exercise price of each option is not less than the market price of the company's stock on the date of the grant. Options granted under the plan have a term of five years to expiry. No compensation expense is recognized when stock options are either issued or exercised.

As at December 31, 2001, options were outstanding for the purchase of common shares as follows:

Number of Shares	Expiry Date	Price per Share
85,000	September 25, 2003	$ 0.50
215,000	June 4, 2004	$ 0.50
100,000	June 25, 2005	$ 0.30
485,000	January 26, 2004	$ 0.50
115,000	April 10, 2006	$ 0.50
20,000	August 15, 2006	$ 0.50

8. Share Capital (continued)

On April 2, 2001, options for 113,000 shares were exercised at $0.40 per share and options for 141,000 shares expired. On April 5, 2001 options for 50,000 shares were exercised at $0.50 per share.

Related Party Transactions

(a) Expenses include the following transactions during the period with related parties all recorded at the exchange amount:

i) The company incurred management fees of $120,000 (2000 – $2,256) to a company controlled by a director.

ii) The company incurred consulting fees of $90,000 (2000 – $87,976) to directors and/or private companies controlled by directors.

iii) The company incurred a management bonus of $40,000 (2000 – $nil) to two directors.

(b) Included in loans payable are amounts of $11,985 (2000 – $11,985) due to a private company having directors in common (this amount does not bear interest and is due on demand).

Contingent Liability

The company is contingently liable to the former shareholders of Garran Oil & Gas Ltd. in the amount of $1,427,377 for a bonus payment on the acquisition of Garran. The liability is contingent on revenues from the properties acquired exceeding a specified target level and expires on January 11, 2006.

Lease Commitments

The company has entered into a lease agreement for its premises expiring September 30, 2007 with minimum aggregate annual payments for the next five years as follows:

2002	$ 122,000
2003	$ 122,000
2004	$ 124,000
2005	$ 132,000
2006	$ 132,000

Income Taxes

The provision for income taxes differs from the result that would be obtained by applying the combined income tax rates of 41.1% (Canadian) and 20.2% (U.S.) to the earnings before income taxes.

	2001	2000
Canadian Operations		
Computed expected tax (recovery)	**$ (282,295)**	$ (48,311)
Increase (decrease) resulting from:		
Reduction in income tax rates	**65,674**	–
Non-deductible crown charges	**801,366**	–
Resource allowance	**(675,801)**	12,652
Share issue costs	**(51,054)**	–
Recognition of prior years temporary differences	**32,280**	(35,608)
Other	**4,871**	4,131
	(104,959)	(67,136)
United States Operations		
Computed expected tax	**(19,113)**	55,000
Income tax expense (recovery)	**$ (124,072)**	$ (12,136)

The company has approximately $64,000 in non-capital losses and $2,800,000 in income tax pools which could be used to reduce income taxes in future years.

12. Income Taxes (continued)

As a result of the acquisition described in Note 14, management feels that it is more likely than not that the future tax benefits will be realized and have recorded them accordingly.

Components of Future Income Taxes

The net future income taxes payable is comprised of:

	2001	2000
Differences between tax base and reported amounts of depletable assets	**$ 9,636,460**	$ (71,267)
Share issue costs	**(221,184)**	–
Future site restoration	**(10,522)**	–
	$ 9,404,754	$ (71,267)

13 Subsequent Events

On February 7, 2002, the company made an offer to acquire all of the outstanding common shares of Tinhorn Resources Ltd. on the basis of 0.9 common share of Redwood for each Tinhorn share. As at February 7, 2002, Tinhorn had 8,474,250 shares outstanding and options to acquire 1,230,800 Tinhorn shares at prices between $0.20 and $0.55. By March 15, 2002, the final acceptance date, 8,214,714 or 97% of the shares had been tendered.

On January 1, 2002 Redwood acquired a producing property from Troodon Energy Ltd. and Contour Energy Ltd. for $1,200,000. The property is contiguous to Redwood's Rosevear property and comprises 4,160 gross acres (1,103 net). An additional 1,600 acre block may be earned by farm-in and the balance of the unearned farm-in acreage may be acquired for an additional $320,000 net to Redwood.

14 Acquisition

On January 12, 2001, the company acquired the shares of a private oil and gas company, whose principal asset is a producing natural gas property. Immediately after the acquisition, the two companies were amalgamated. The purchase price for this company was a combination of cash, convertible debentures and common shares of the company.

This acquisition was accounted for by the purchase method summarized as follows:

Capital assets	$24,359,000
Site restoration	(8,000)
Future income taxes	(9,651,000)
	$14,700,000

The acquisition was financed by:

Common shares	$ 3,750,000
Debentures	1,000,000
Cash	9,950,000
	$14,700,000

15 Interest and Income Taxes Paid

During the period, the company had cash flows arising from interest and income taxes as follows:

	2001	2000
Interest paid	**$ 572,052**	$ 27,874
Income taxes paid	**$ 34,322**	$ –

2001 Quarterly Information	Q1	Q2	Q3	Q4	**2001**
Financial *($ thousands, except where noted)*					
Petroleum and natural gas sales	3,520	2,681	1,309	989	**8,499**
Cash flow from operations	1,771	1,360	353	824	**4,308**
Per share – basic ($)	.09	.07	.02	.04	**.21**
– fully diluted ($)	.07	.05	.01	.04	**.21**
Net income	480	54	313	(1410)	**(563)**
Per share – basic ($)	.03	.00	.02	(.07)	**(.03)**
– fully diluted ($)	.02	.00	.01	(.07)	**(.03)**
Operations					
Daily production					
Natural gas (mcf)	4,073	3,537	2,889	2,740	**3,239**
Crude oil and NGLs (bbls)	133	97	74	73	**86**
Prices					
Natural gas ($/mcf)	9.81	7.23	3.78	3.76	**6.28**
Crude oil and NGLs ($/bbls)	34.67	35.46	28.97	23.35	**34.02**
Wells drilled					
Gross	0	1.00	2.00	0	**3.00**
Net	0	.12	1.10	0	**1.22**
Share trading information					
Volume (thousands)	1,080	1,111	1,026	579	**3,796**
High ($)	.70	.75	.70	.52	**.75**
Low ($)	.45	.41	.48	.39	**.39**
Close ($)	.52	.59	.52	.52	**.52**

2000 Quarterly Information	Q1	Q2	Q3	Q4	2000
Financial *($ thousands, except where noted)*					
Petroleum and natural gas sales	–	–	–	–	163
Cash flow from operations	(11)	(76)	(53)	(64)	(204)
Per share – basic ($)	.00	(.01)	(.01)	(.01)	(.03)
– fully diluted ($)	.00	(.01)	(.01)	(.01)	(.03)
Net income	445	(93)	80	(5)	427
Per share – basic ($)	.05	(.01)	.01	.00	.06
– fully diluted ($)	.05	(.01)	.01	.00	.06
Operations					
Daily production					
Natural gas (mcf)	26	34	0	0	15
Crude oil and NGLs (bbls)	5	6	8	5	6
Prices					
Natural gas ($/mcf)	3.47	2.90	N/A	N/A	3.15
Crude oil and NGLs ($/bbls)	42.38	10.33	43.73	41.73	43.44
Wells drilled					
Gross	1.00	0	0	0	1.00
Net	.35	0	0	0	.35
Share trading information					
Volume (thousands)	189	364	659	860	2072
High ($)	.84	.40	.49	.55	.84
Low ($)	.30	.18	.20	.36	.18
Close ($)	.35	.40	.41	.50	.50

Directors and Officers

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PROPHET PETROLEUMS LTD.

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Stock Listing

CDNX: RWD

Abbreviations

mcf	*thousand cubic feet*	*mmbbl*	*million barrels*
mmcf	*million cubic feet*	*boe*	*barrel of oil equivalent 6:1 (6 mcf = 1 bbls)*
bcf	*billion cubic feet*		
bbls	*barrels*	*/d*	*per day*
mbbls	*thousand barrels*	*NGLs*	*natural gas liquids*

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